CONSTRUCTION & ENGINEERING GUIDE
April 2013

Approaches to insuring existing buildings in which and/or next to which construction work is to take place

JCT CONTRACTS
Those involved in UK building projects - property developers, funders, contractors and consultants - will all be familiar with JCT building contracts (http://www.jctltd.co.uk/); the suite of agreements produced by the Joint Contracts Tribunal are the most commonly used contracts in the domestic construction market.

Most developments generally tend to be new builds, with the construction work being built on empty sites. It is, however, not uncommon for construction work to take place in, on and next to existing buildings. This is particularly the case in urban areas, within the retail and office accommodation sectors and is likely to become far more commonplace in the new few years as the new minimum energy standards for letting buildings, required by the Energy Act 2011, take effect:

MINIMUM ENERGY STANDARDS FOR LETTING BUILDINGS
From April 2018, proposed legislative changes will make it unlawful to let residential or commercial properties with an EPC rating of F or G (the lowest two grades of energy efficiency). This could have very significant implications for landlords and occupiers who wish to let, assign or sub-let space. In light of this development, in the run up to 2018, property owners and occupiers should make sure they have a clear understanding of the energy efficiency of the property assets. Thereafter, owners and occupiers will need to assess the costs and viability of undertaking retrofits or refurbishments and possibly bringing forward properties for marketing prior to 2018 or re-gearing leases.

This guide considers building work commissioned by a client at an existing property where the construction works themselves take place adjacent to structures that already exist.

JCT INSURANCE OPTION C
Generally, where works are carried out to an existing structure, under a JCT building contract, the intention is that JCT insurance option C, set out in schedule 3 to the JCT contract ("Option C"), is meant to apply.

Under Option C, the employer is required to take out and maintain insurance both in respect of the works (as they are built) as well as the existing structure. The policy is meant to cover the full cost of reinstatement, repair and/or replacement of loss or
damage to the existing structure due to the occurrence of a "Specified Peril".

The list of what constitutes a "Specified Peril" includes fire, lightning, explosion, storm, flood, escape of water from any water tank, apparatus or pipe, earthquake, aircraft and other aerial devices or articles dropped therefrom, riot and civil commotion. The insurance policy is to be in the joint names of the contractor and the employer. The insurers are to waive any rights of recourse they may have against the employer and the contractor as well as sub-contractors who are to be recognised as insureds thereunder.

This is all relatively straightforward if the employer is the owner of the building and has taken out its own buildings insurance. If, however, the employer is the tenant in the building and the buildings insurance is maintained by the landlord, then the matter is not quite so simple.

Generally, landlords are reluctant to include tenants' contractors, let alone sub-contractors, as insureds under their buildings insurance policies. This is because doing so would affect their premiums. As a result, the employer tenant is not in a position to satisfy the requirements of Option C.

**WHAT IS THE SOLUTION? AN ALTERNATIVE TO OPTION C:**

Where the employer under the building contract is a tenant in a building, it needs to think about putting in place alternative insurance arrangements.

The alternative arrangements usually boil down to requiring the contractor to maintain third party/public liability insurance, with an appropriate level of cover, to respond to any damage caused to the building in which the works are to be carried out.

This approach entails either:

- Amending Option C - such that the employer is not obliged to maintain insurance of the existing buildings and its contents but still required to insure the works themselves (with consequential amendments being made to other clauses, such as clause 6.2, which cross-refer to Option C); or
- The use of either JCT Insurance Options A or B (depending on whether it is the contractor or the employer who is to insure the works) - so that any damage to the existing structure would be dealt with in the same way as damage caused to third party property (some amendments to the JCT contract will be required including removing references to "New Build" from Option A or B, as appropriate).

**TAKE CARE; BEWARE**

However, whilst the above 'solution' is not an unusual one, it is not a perfect substitution for the usual Option C insurance arrangements.

The material differences between the two include the following:

- if the employer tenant uses the alternative "solution", it will be the contractor who will have responsibility for (and be required to maintain) the public liability insurance. This means that, if the contractor fails to maintain that insurance properly, the employer will have to look to the contractor itself to cover any shortfall in insurance recovery;
- there is a risk that the public liability insurance cover to be maintained by the contractor may not be sufficient to cover reinstatement costs in the event of any substantial damage to or the entire destruction of the building;
- under the JCT building contract, the contractor's public liability insurance is only required to react to damage to property caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom it is responsible. Therefore, this insurance will not react to damage to the building caused by Specified Perils, which are the risks normally expected to be covered by Option C, unless it can be established that their occurrence has been caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom it is responsible.

**ADVICE**

Consequently, it becomes clear that consideration needs to be given to the insurance arrangements for existing buildings at an early stage in the procurement process and advice sought from appropriately qualified insurance advisers to put in place suitable insurance arrangements.

**CONTACT**

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With specialists across the UK, our Construction & Engineering Group is uniquely placed to advise our clients in relation to all types of construction, development, engineering and infrastructure project and dispute resolution procedure - wherever they are and wherever their projects are. Find out more about our Construction & Engineering UK and global practices.

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REALWORLD

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REALWORLD is our interactive online guide to real estate that provides answers to the key questions that arise when entering foreign real estate markets.

The site covers questions related to sale and purchase, real estate finance, leases, construction, planning and zoning, real estate taxes and corporate vehicles. It allows users to compare the way in which issues in any two (or more) different countries are dealt with and help evaluate the possible options.

WHAT IN HOUSE LAWYERS NEED (WIN)

Knowledge, support and networking for the in-house lawyer community

WIN is the DLA Piper programme for in-house lawyers. The aim of the programme is to listen to our clients and identify the key legal and commercial issues in-house lawyers face on a day to day basis so we can tailor our services to meet their changing needs and priorities.

Many of our in-house clients are helping us shape the agenda so that it remains topical and relevant. Clients can join the discussion at www.dlapiperwin.com and tell us what topic areas are of interest for access to a master-class programme of targeted updates and educational networking events.

For more information or to request additional information on WIN please contact Richard Norman or Bethany Jennings via www.dlapiperwin.com.